

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition  
of  
The Manhattan Savings Bank

:

:

: AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or a Revision :  
of a Determination or a Refund of Franchise Tax on :  
Banking Corps. under Article 32 of the Tax Law :  
for the Years 1974 & 1975.

State of New York  
County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 26th day of June, 1981, he served the within notice of Decision by certified mail upon The Manhattan Savings Bank, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

The Manhattan Savings Bank  
385 Madison Ave.  
New York, NY 10017

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this  
26th day of June, 1981.

*Annice P. Hegeland*

*J. Vredenburg*

STATE OF NEW YORK  
STATE TAX COMMISSION

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In the Matter of the Petition :  
of :  
The Manhattan Savings Bank :

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for Redetermination of a Deficiency or a Revision :  
of a Determination or a Refund of Franchise Tax  
on Banking Corps. under Article 32 of the Tax Law :  
for the Years 1974 & 1975.

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State of New York  
County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 26th day of June, 1981, he served the within notice of Decision by certified mail upon John A. Pileski the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Mr. John A. Pileski  
Peat, Marwick Mitchell & Co.  
345 Park Ave.  
New York, NY 10154

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this  
26th day of June, 1981.

*Charles P. Hyslop*

*J. Vredenburg*

STATE OF NEW YORK  
STATE TAX COMMISSION  
ALBANY, NEW YORK 12227

June 26, 1981

The Manhattan Savings Bank  
385 Madison Ave.  
New York, NY 10017

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1455 of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Laws and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance  
Deputy Commissioner and Counsel  
Albany, New York 12227  
Phone # (518) 457-6240

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative  
John A. Pileski  
Peat, Marwick Mitchell & Co.  
345 Park Ave.  
New York, NY 10154  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition  
of  
THE MANHATTAN SAVINGS BANK  
for Redetermination of a Deficiency or for  
Refund of Franchise Tax on Banking Corporations:  
under Article 32 of the Tax Law for the Years  
1974 and 1975.

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DECISION  
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Petitioner, The Manhattan Savings Bank, 385 Madison Avenue, New York, New York 10017, filed a petition for redetermination of a deficiency or for refund of franchise tax on banking corporations under Article 32 of the Tax Law for the years 1974 and 1975 (File No. 27911).

A formal hearing was held before Doris Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on December 9, 1980 at 2:00 P.M. Petitioner appeared by Peat, Marwick, Mitchell & Co. (John A. Pileski, CPA). The Audit Division appeared by Ralph J. Vecchio, Esq. (Frank Levitt, Esq., of counsel).

ISSUE

Whether petitioner properly netted interest against interest penalties in computing the alternative tax on dividends under section 1455(b)(2) of the Tax Law.

FINDINGS OF FACT

1. On or about July 19, 1978, the Audit Division issued to petitioner, The Manhattan Savings Bank, two notices of deficiency asserting additional franchise taxes due under Article 32 of the Tax Law for the years 1974 and 1975 in the amounts \$1,530.76 and \$1,535.88, respectively, plus interest thereon.

The statements of audit adjustment, issued to petitioner under date March 23, 1978, explained that petitioner's netting of penalty charges with dividends and interest paid had been disallowed, and petitioner's tax liability under section 1455(b)(2) recomputed.

2. Petitioner is a savings bank organized under the laws of this state.

3. At the time a depositor takes a certificate of deposit from a bank, the parties enter into a contract which sets forth their rights and obligations with respect to interest to be earned, as well as penalties to be imposed upon the depositor's premature withdrawal of funds. There are two authorized methods for the computation of interest to be reported by the savings institution, and of the loss (penalty) deductible by the depositor:

(a) the gross method -- Interest is computed to the date of premature withdrawal and then reduced, usually by reduction of the interest rate to the passbook rate and by forfeiture of 90 days' interest.

(b) the modified method -- Interest is computed to the last date withdrawable interest was credited to the depositor's account (e.g., the end of a calendar quarter); the depositor forfeits any interest accrued but unpaid.<sup>1</sup>

During the years at issue, petitioner applied the gross method to most accounts.

4. In computing the tax under section 1455(b)(2), petitioner took the interest credited in each category of account, taking cognizance of any penalties imposed, and multiplied it by a factor, the numerator of which was the three and one-half percent statutory rate and the denominator of which was the contract rate for that account category, to obtain (in petitioner's view) the

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<sup>1</sup> See Rev. Rul. 73-511, 1973-2 C.B. 402; Rev. Rul. 75-21, 1975-1 C.B. 367.

interest which would have been credited had interest been computed at the statutory rate.

Petitioner's computations for 1974 were as follows:

<u>DIVIDENDS PAID</u>		<u>RATE</u>	<u>FACTOR</u>	<u>BASE AMOUNT OF DIVIDENDS</u>
Regular accounts	\$19,864,080.61	5.25	.6666	\$13,241,396.13
DOD/DOW accounts	16,330,999.82	5.25	.6666	10,886,244.48
Club accounts	46,820.07	5.25	.6666	31,210.26
Escrow accounts	5,196.38	2.00	1.0000	5,196.38
Total dividends	<u>\$36,247,096.88</u>			<u>\$24,164,047.25</u>

INTEREST PAID  
CERTIFICATES OF DEPOSIT

\$	13.84	5.00	.7000	\$	9.69
	2,545.31	5.25	.6666		1,696.70
	181.36	5.50	.6363		115.40
	304,177.78	5.75	.6086		185,122.60
	4,581,868.31	6.00	.5833		2,672,603.79
	208.28	6.25	.5600		116.64
	3,668,494.49	6.50	.5384		1,975,177.43
	3,160,976.55	6.75	.5185		1,638,966.34
	3,237,080.29	7.00	.5000		1,618,540.15
	12,864.11	7.15	.4895		6,296.98
	34,241.70	7.25	.4827		16,528.47
	3,609,459.16	7.50	.4666		1,684,173.64
	2,493,588.60	7.625	.4590		1,144,543.40
	138,539.38	7.75	.4516		62,564.38
	27,749.86	7.875	.4444		12,332.04
	38,229.50	8.00	.4375		16,725.41
	230.30	8.25	.4242		97.69
	16,812.75	8.50	.4117		6,921.81
	9,063.71	8.75	.4000		3,625.48
	6,363.52	9.00	.3888		2,474.14
	<u>\$21,342,658.80</u>				<u>\$11,048,572.18</u>

Petitioner's 1975 computations were as follows:

<u>DIVIDENDS PAID</u>		<u>RATE</u>	<u>FACTOR</u>	<u>BASE AMOUNT OF DIVIDENDS</u>
Regular accounts	\$17,608,595.76	5.25	.6666	\$11,737.889.93
DOD/DOW accounts	20,127,799.87	5.25	.6666	13,417,191.39
Club accounts	38,719.27	5.25	.6666	25,810.27
Escrow accounts	10,588.90	2.00	1.0000	10,588.90
Total dividends	<u>\$37,785,703.80</u>			<u>\$25,191,480.49</u>

INTEREST PAID  
CERTIFICATES OF DEPOSIT

\$ 215,798.42	5.75	.6086	\$ 131,334.92
901,683.94	6.00	.5833	525,952.24
16,276.88	6.25	.5600	9,115.05
4,752,064.76	6.50	.5384	2,558,511.67
4,166,834.18	6.75	.5185	2,160,503.52
3,384,780.77	7.00	.5000	1,692,390.39
13,930.18	7.15	.4895	6,818.82
38,209.67	7.25	.4827	18,443.81
6,564,743.16	7.50	.4666	3,063,109.16
2,636,430.78	7.625	.4590	1,210,121.73
1,428,052.17	7.75	.4516	644,908.36
21,773.44	7.875	.4444	9,676.12
16,844.63	8.00	.4375	7,369.53
23,157.07	8.50	.4117	9,533.77
17,833.97	9.00	.3888	6,933.85
44,663.16	10.00	.3500	15,632.11
<u>\$24,243,077.18</u>			<u>\$12,070,355.05</u>

5. At the request of the Audit Division, petitioner furnished the following schedule of penalty charges, by account type, for 1974 and 1975:

<u>ACCOUNT TYPE</u>	<u>1974</u>	<u>1975</u>
5.75	\$ 1,393.03	\$ 44.61
6.00	40,589.41	2,939.26
6.50	14,805.33	17,588.97
6.75	25,544.57	17,124.25
7.00	22,129.16	17,591.38
7.15	702.78	--
7.50	21,040.61	50,205.33
7.625	19,987.67	10,879.40
7.75	871.35	3,295.44
8.00	--	624.30
	<u>\$147,063.91</u>	<u>\$120,292.94</u>

6. In accordance with its position that interest and penalties may not be netted in computing the tax base, the Audit Division applied the statutory rate of three and one-half percent to total interest, disregarding the penalties imposed; for 1974, the tax base was computed at \$35,289,157.50 and for 1975, \$37,320,907.61. The Audit Division arrived at the tax base as follows: base amount of dividends (after application of the factor appropriate for each

account category to the amount of dividends) plus base amount of interest (after application of the appropriate factors) plus base amount of penalties. The last figure was computed by multiplying the amount of penalty in each account category by the same factor used to calculate the base amount of interest.

	<u>1974</u>	<u>1975</u>
Base amount of dividends	\$24,164,047.25	\$25,191,480.49
Base amount of interest	11,048,572.18	12,070,355.05
Base amount of penalties	76,538.07	59,072.07
	<u>\$35,289,157.50</u>	<u>\$37,320,907.61</u>

7. For the years at issue, petitioner filed a Federal consolidated return with its subsidiaries. In 1974, petitioner took an interest deduction in the amount \$57,973,364.82, of which \$57,736.819.59 was attributed to petitioner, according to the Consolidated Income and Expense Schedule submitted with the Federal return for that year. A similar schedule for the latter year showed an interest deduction taken in the amount \$62,543,000.20, of which \$62,149,073.92 was attributed to petitioner.

#### CONCLUSIONS OF LAW

A. That section 1451 of the Tax Law imposes upon every banking corporation exercising its franchise or doing business in this state a tax to be computed under section 1455. Subdivision b of section 1455 provides the method for computation of the alternative minimum tax; paragraph 2 of said subdivision provides:

"For a savings bank and savings and loan association, two percent of the interest or dividends credited by it to depositors or shareholders during the taxable year, provided that, in determining such amount, each interest or dividend credit to a depositor or shareholder shall be deemed to be the interest or dividend actually credited or the interest or dividend which would have been credited if it had been computed and credited at the rate of three and one-half percent per annum, whichever is less."

B. That there is no provision whatsoever in Article 32 for netting of interest and penalties for premature withdrawal of funds, in calculating the tax base.

C. That netting, as contemplated by petitioner, would result in different tax liabilities for similarly situated taxpayers, depending upon which method they adopted: application of the three and one-half percent rate to principal on deposit, application of the aforementioned factor to interest reported in accordance with the gross method, or application of the factor to interest reported in accordance with the modified method. When penalties are taken into consideration, the tax computation results are the same regardless of method chosen.

D. That for purposes of the Federal income tax on banking institutions, section 591 of the Internal Revenue Code allows a deduction for dividends or interest paid on deposits, as follows:

"In the case of mutual savings banks, cooperative banks, domestic building and loan associations, and other savings institutions chartered and supervised as savings and loan or similar associations under Federal or State law, there shall be allowed as deductions in computing taxable income amounts paid to, or credited to the accounts of, depositors or holders of accounts as dividends or interest on their deposits or withdrawable accounts, if such amounts paid or credited are withdrawable on demand subject only to customary notice of intention to withdraw."

During the years at issue, petitioner took a full deduction for interest credited, disregarding early withdrawal penalties, as it had the right to do under said section.<sup>1</sup> Having done so, it is inconsistent for petitioner to now argue that the full amount of interest (disregarding penalties) was not "credited" and should not enter into the computation under section 1455(b)(2).

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<sup>1</sup> Where the taxpayer has the contractual right to retain or recover a portion of interest as a penalty for premature withdrawal of funds, it must include such amounts in its gross income in the taxable year in which it exercised such right. Treas. Reg. 1.591-1(b); Rev. Rul. 73-220, 1973-1 C.B. 297.

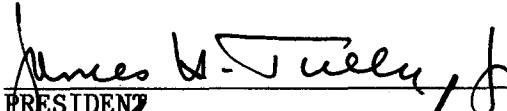
E. That petitioner may not net interest and penalties in calculating tax under section 1455(b)(2).


F. That the petition of The Manhattan Savings Bank is hereby denied and the notices of deficiency issued July 19, 1978 are sustained in full.

DATED: Albany, New York

STATE TAX COMMISSION

JUN 26 1981

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER